No. 17,387

IN THE

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

CHARLES E. and LOIS W. ROSEBROOK,
Appellees.

On Appeal from the Judgment of the United States District Court for the Northern District of California

BRIEF FOR APPELLEES

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BRIEF FOR APPELLEES

I. OPINION BELOW

The District Court for the Northern District of California on October 19, 1960, entered a "Memorandum and Opinion" (R. 11-18) reported at 191 F. Supp. 356 (1960) in favor of Plaintiffs-Appellees. It entered its Findings of Fact and Conclusions of Law and Judgment (R. 19-27) on January 3, 1961.

II. JURISDICTION

This appeal involves United States income taxes for the calendar year 1955. The Commissioner of Internal Revenue assessed a deficiency of $303.72 taxes plus $59.37 interest against Appellees, which was paid on September 28, 1959. A claim for refund thereof was filed on September 29, 1959, and was denied by certified mail on December 17, 1959. On December 18, 1959, taxpayers brought an action in Federal District Court for refund of the amount paid. Jurisdiction was conferred on the District Court by 28 U.S.C. 1346(a)(1). Judgment was entered for Plaintiffs (Appellees) on January 3, 1961. On March 2, 1961, Notice of Appeal was filed by the United States of America. Jurisdiction is conferred on this Court by 28 U.S.C. 1291.

III. QUESTIONS PRESENTED

Does the evidence sustain the District Court's Findings and Conclusions that Appellee, Lois W. Rosebrook, sold an interest in property which was a capital asset in her hands within the meaning of §1221 of the Internal Revenue Code of 1954, and that the said interest in property sold by Appellee was not held by her primarily for sale to customers in the ordinary course of a trade or business.

IV. STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, infra.

V. STATEMENT OF FACTS

Appellee, Lois W. Rosebrook,[1] was married to Appellee, Charles W. Rosebrook, on February 12, 1955. Said parties filed a joint income tax return for the year 1955 with the District Director of Internal Revenue in San Francisco. (R. 8.)

Appellee was graduated from Stanford University in 1946, with a B.A. degree, majoring in English. From 1946 to 1953, she was a housewife, sometimes working as a medical receptionist. From 1953 to 1955 she worked for an auto rental firm, a rug cleaning firm, and briefly, for her father as a secretary. Since February 12, 1955, she has been a housewife and has not been otherwise employed. (R. 16-20.)

Appellee has never held a real estate broker's or salesman's license and has no pattern or background of real estate activity. (R. 16.) She has never entered into any written or oral partnership agreement or signed a partnership tax return in connection with a real estate venture and has no background or pattern of activity in the real estate business. (R. 20, 32-35.)

In 1942, when Appellee was a minor, her parents, George W. and Hortense Williams, created an irrevocable trust for her benefit. Said trust acquired various assets, including an undivided interest as tenant in common in 1159.6 acres of land in San Bruno, Cali-

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[1]The interest in land, sale of which is the subject of this suit, was separate property of Lois W. Rosebrook. Charles E. Rosebrook is a party only by reason of having filed a joint return with Lois W. Rosebrook. Hereinafter, the term "Appellee" refers to Lois W. Rosebrook only.

fornia, in May of 1953. (R. 9.) George W. Williams was sole trustee of said trust. (R. 20.)

Sometime prior to 1953, George W. Williams had acquired an option on and was attempting to purchase the aforementioned acreage of land but was not able to obtain sufficient financing. (R. 21.) He therefore interested a group including himself, Frank Burrows, Andrew Conway, Thomas Culligan, and Martin Wunderlich in joining with him in the purchase. It was understood that the above parties were acting not only for themselves but for other interests to be represented by them. (R. 12, 21.)

On April 23, 1953, the above parties entered into an agreement whereby they would purchase the stock of San Bruno Lands, Incorporated, for a total of $1,150,000 for the purpose of acquiring the land owned by said corporation. (R. 12, 21.)

On April 23, 1953, a writing entitled "Memorandum" was initialed by the above parties. (R. 12, 81-82.) The purpose of this Memorandum was to record the intention of the parties that Conway and Culligan would be entitled to an increased participation from 1/6 (their interest in the land) to 1/3 if the parties formed a corporation or corporations to participate in ultimate development in the land. (R. 96, 104-106, 107, 108, 126-127.) This course of action outlined by the Memorandum was only one of many alternatives considered. (R. 102-107, 125-127.) The course of action outlined by the Memorandum was not carried out according to its terms, in that an outside interest, i.e., Boetcher & Co., became an incorporator

and substantial shareholder of Consolidated Lands, Inc. (R. 13, 22, 107.) It was not intended to be a contract; written contracts were always signed by the parties (R. 103-104, 126); but merely a memorandum recording a contingent future intention which did not affect most of the parties. (R. 106 and 127.) Said Memorandum was not signed or initialed by Appellee and does not mention her or affect the quantum of her interest in any way. (R. 104.) She was traveling abroad at the time it was written. (R. 135.)

On May 7, 1953, a number of people, including George W. Williams as trustee of a trust for the benefit of Appellee, entered into an agreement with Williams, Conway and Wunderlich whereby said three men would acquire the subject property and immediately convey it to them in stated percentages, the interest of the aforementioned trust to be one per cent. (R. 12-13, R. 21.) This procedure was followed because the sellers refused to deal with more than three people. (R. 63.)

Thereupon, said three individuals purchased the stock of San Bruno Lands, dissolved the corporation, took title to the land in their own names, and on June 8, 1953, conveyed it to all of the tenants in common, according to their respective contributions. (R. 12-13, R. 21-22.)

Among the contributors was the trust for the benefit of Appellee, which contributed $7,000 cash toward the purchase price of the land and received a one per cent undivided interest. (R. 22.) The trust and the other parties held their interests as tenants in

common, each individual tenant paying his share of taxes and interest. (R. 23.)

Appellee's father did not commit the trust of Appellee to a business purpose in holding the land. (R. 17, 22.) Appellee had no knowledge of the existence of the Memorandum of April 23, 1953, and "knew nothing about it"; (i.e., Consolidated Lands, Inc., or any plan for ultimate development of the land). (R. 15, 24, 45.)

The trust for the benefit of Appellee was terminated on December 18, 1953, when Appellee was 28 years old, and the property, including the undivided interest in 1159.6 acres, was unconditionally distributed to her. (R. 40.) No power of attorney relating to the property was granted by Appellee. (R. 23.) The trust from which Appellee acquired her interest never sold an interest in land. (R. 16, 23.)

On February 10, 1954, the tenants in common of the 1159.6 acres, by installment sale, sold and conveyed 884.2 acres of the parcel of land to Consolidated Lands, Inc., a corporation which had been formed in October, 1953, by some of the principals plus a substantial interest in an outside party. (R. 22-23, 90, 107.) They received cash plus an interest in a note. Appellee was not an officer, director or shareholder in Consolidated Lands, Inc. (R. 24, 45.) Appellee had no further interest in the property after it was sold. (R. 13-15, 16.) The sale in question was Appellee's first sale of a parcel or interest in land (R. 16), and she has made only one subsequent sale

(R. 16), and she has no pattern of real estate activity or employment. (R. 16, 20.)

Appellee reported her share of the profit for the year of 1954 and subsequent years as long-term capital gain. For the year 1955 the Commissioner of Internal Revenue determined that installment receipts were taxable as ordinary income and assessed a deficiency against Appellee, after payment of which Appellee filed a claim for refund. Said claim was denied, and this suit was brought to recover said tax. (R. 25.)

VI. SUMMARY OF ARGUMENT

A. The question of whether a taxpayer holds property for sale to customers in the ordinary course of a trade or business within the meaning of 26 U.S.C. §1221 is a question of fact. There is ample evidence in the record to support the trial Court's finding of fact that Appellee's interest was a capital asset. "The evidence negatives any (other) inference." (R. 18.)

B. Appellee was not a member of a partnership or joint venture. The evidence amply supports specific findings which preclude her membership in a true joint venture or partnership.

C. Even if Appellee were held to be a member of a joint venture, the (assumed) intention or purpose of others to hold the property for sale to customers in the ordinary course of a trade or business would not be imputed to her. The intention or purpose of the individual partner is controlling of the tax effects

under IRC §702(b), not the (supposed) intention of the entity.

D. If it is decided that the trial Court held Appellee to be a member of the joint venture and the intent of others is thereby imputed to her, the case must be remanded for retrial because the only evidence supporting this conclusion was improperly admitted into evidence without foundation and over objection of Appellee's counsel.

VII. ARGUMENT

A. THE QUESTION OF WHETHER A TAXPAYER HOLDS PROPERTY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF A TRADE OR BUSINESS WITHIN THE MEANING OF 26 U.S.C. §1221 IS A QUESTION OF FACT. THERE IS AMPLE EVIDENCE IN THE RECORD TO SUPPORT THE TRIAL COURT'S FINDING OF FACT THAT APPELLEE'S INTEREST WAS A CAPITAL ASSET. "THE EVIDENCE NEGATIVES ANY (OTHER) INFERENCE." (R. 18.)

The question of whether one holds property for sale to customers in the ordinary course of a trade or business is a question of fact, and the Court has never substituted legal tests for a determination of this basic question of fact. *Stockton Harbor Industrial Co. v. Commissioner,* 216 F.2d 638 (C.A. 9, 1954); also see *Austin v. Commissioner,* 263 F.2d 460 (C.A. 9, 1959), where the cases to support this point of law are gathered. The record is replete with evidence that Appellee did not have such intention or purpose, and the trial Court so found as a fact. The District Court stated that the record specifically *negatives* such in-

tention. (R. 18.) After listing the District Court's finding as to Appellee's intent as one of the points to be urged on appeal (Appellant's Brief, page 6, Statement No. 2), Appellant does not again seriously urge that Appellee personally had the intention or purpose to hold her interest for sale to customers in the ordinary course of a trade or business.

A capital asset is defined in §1221 of the Internal Revenue Code as including all property except certain types of property specifically excepted therefrom. The exception which Appellant seeks to bring this case under is "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The law is clear that these words must be used in their ordinary and usual sense. This Court said in *Austin v. Commissioner,* 263 F.2d 460 (C.A. 9, 1959):

> "The words and phrases 'trade or business', 'ordinary' and 'customers' are to be construed in their ordinary meanings. 'To be engaged in the real estate business means to be engaged in that business in the sense that the term usually implies.' *Yunker v. Commissioner of Internal Revenue,* 256 F.2d 130. The word 'business' '. . . implies that one is kept more or less busy, that the activity is an occupation. . . . It ordinarily is implied that one's own attention and efforts are involved . . .' *Snell v. Commissioner of Internal Revenue,* 97 F.2d 891. As stated in *Fahs v. Crawford,* 161 F.2d 315, at page 317 . . . 'Carrying on a business, however, implies an occupational undertaking to which one habitually devotes time, attention, or effort with substan-

> tial regularity. Merely disposing of investment assets at intermittent intervals, without more, is not engaging in business, even though some preliminary effort is necessary to render the asset saleable.' "

In the present case the evidence shows beyond doubt that Appellee had no customers or trade or business of selling real estate, and her only purpose in holding the property which she received by gift was to make this, her first sale, at a gain. (R. 43, 44.) We submit that there is not one scintilla of evidence showing any other purpose. Although frequency of transactions is only one of the tests of whether one is a dealer in real property, in no cases that we have found has a taxpayer been held to be a dealer on her first sale. This result would be particularly shocking if, as here, there is no subsequent pattern of real estate activity, and taxpayer by education, background and station in life is not associated with the business of selling real estate.

The Tax Court, in a case involving a sister of Appellee in a situation arising from the same facts from which the present case arose, held that the sister did not have the intention to hold property for sale to customers in the ordinary course of a trade or business.[2] It would be anomalous indeed for Appellee to have, as a matter of fact, a different intention than her sister.

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[2]*Katherine Anne Berryman v. Commissioner,* 37 T.C. No. 6 (1961).

The basic question being one of fact, if there is adequate evidence in the record upon which the judgment of the District Court can be affirmed, it must be affirmed; and on this point we submit it would be difficult to conjure up a stronger case for affirmance. Erroneous assumptions in the Memorandum Opinion (if there be such) are not grounds for reversal where the basic question is one of fact and the evidence supports the District Court's findings. It is not necessary for this Court to go beyond this point to affirm the District Court.

B. APPELLEE WAS NOT A MEMBER OF A PARTNERSHIP OR JOINT VENTURE. THE EVIDENCE AMPLY SUPPORTS SPECIFIC FINDINGS WHICH PRECLUDE HER MEMBERSHIP IN A TRUE JOINT VENTURE OR PARTNERSHIP.

We submit that this case involves a simple question of fact in which the District Court's decision is adequately supported by the record, and that the argument above is dispositive of the matter. However, since the Appellant goes at length into a number of matters (which we submit are irrelevant), we are constrained to point out certain basic errors in the inference which Appellant draws from the Memorandum Opinion of the trial Court.

The District Court said that if this were "a true business partnership" it would hold that Appellee realized ordinary income by virtue of being in the real estate business. Appellant builds a complex structure on the simple remark taken out of context from

the Memorandum Opinion. It is elementary hornbook law that the basic difference between a partnership and a joint venture (for substantive law rather than tax law purposes) is that a partnership is a form chosen for continuity of an enterprise which, over a period of time, maintains a continuing business, as contrasted with the joint venture, which is a form chosen when several people come together to carry out a "one shot" project. Clearly, if taxpayer were one of a group of people engaged in a continuous course of conduct of buying and selling real estate, taxpayer would not be entitled to capital gains treatment with respect to the fruits of the continuous conduct. This, we submit, is what the District Court was saying, and no more.

We do not think the Court was using the term "joint venture" in the restrictive sense used by IRC §761(a), nor do we read the Memorandum Opinion as finding that Appellee was a member of a joint venture as that term is known in tax law and then holding that such entity was, nevertheless, to be treated differently than a partnership for tax purposes. The evidence amply supports the findings which preclude her membership in a true joint venture or partnership.

It is interesting to note that in the statement of Appellant's case only the Memorandum Opinion is used as a basis for the statement of facts. (See Appellant's Brief, page 2.) The term "joint venture" can be used to mean a business partnership for one undertaking. On the other hand, it can loosely mean joint ownership or joint investment—a joint endeavor where no

business is carried on, or even an undertaking of a social or non-profit nature by more than one person.[3] It is clear that the trial Court, in the Memorandum Opinion, used the term "joint venture" as joint ownership or joint investment and did not use it synonymously with a partnership for a single undertaking. Consider the following:

(1) The specific Findings of Fact and Conclusions of Law which are the official findings of the Court,[4] did not use the terms "joint venture" or "partnership".

(2) Other findings by the Court specifically negative the possibility of a true joint venture as that term is used by IRC §761(a). For example:

(a) ". . . (Appellee) . . . has never entered into any written or oral partnership agreement or signed a partnership tax return in connection with venture hereinafter considered. . . ." (R. 20.)

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[3]In *Pence v. Berry*, 13 Wash. 2d 564, 125 P.2d 645 (1942), the Court extended the term "joint venture" to the sharing of expenses of an automobile trip to a college football game. The Court said: "The joint venture, as a useful legal device, is therefore not limited to strictly business transactions, but may also find application in connection with enterprises having the attainment of pleasure as their sole objective, so long as the association of the parties is not motivated merely by a desire for social companionship."

See also, Taubman, *The Joint Venture and Tax Classification*, Federal Legal Publications, Inc., New York, 1957, where it was said at page 99: "The terms of the relationship, other than the fact of profit sharing, may be so shadowy that it might easily be considered something else; *e.g.*, a debtor-creditor transaction, a brokerage agreement, an employment contract, an independent contractor agreement, an agency, or a lease."

[4]Fed. Rules Civil Proc. No. 52.

(b) "Said trust property was conveyed to (Appellee) without any oral or written conditions attached thereto." (R. 23.)

(c) Appellee held her interest as tenant in common and not as tenancy by co-partnership. (R. 9, 22.)

(d) Property taxes and interest were paid by each individual tenant in common, including Appellee, in proportion to his or her interest in the property, and were not paid by any entity. (R. 23.)

(e) ". . . George W. Williams, as trustee, did not commit the trust for the benefit of the Plaintiff (Appellee), or the Plaintiff, to a purpose of holding property for sale to customers in the ordinary course of a trade or business." (R. 24.)

(f) ". . . (Appellee) is not a member of any partnerships dealing in real estate and has no background or pattern of real estate activity or employment." (R. 16.)

(g) Appellee "knew nothing about it;" (i.e., an intention by a group or joint venture to which Appellant alleges she belonged to develop the land through a corporation).

(3) Appellee did not even know and had never met at least three of her supposed partners or joint venturers. (R. 119.) Any joint venture or partnership would have had to be an involuntary one as far as Appellee was concerned.

(4) There has been no suggestion by the Court or the Appellant that a partnership tax return should

have been filed, although the law would have required one had there been a true joint venture in existence.

(5) The District Court, in its Memorandum Opinion, stated:

> "The intent and purpose of participants in a joint venture, which contemplates a sale of their respective realty interest to an ultimate purchaser, as in this case a development company, might be quite different one from another. For some it may be just a step in carrying on their business; for others it may be merely *a single opportune investment* with a view of ultimate profit but unrelated to any business of the participant, as in the case of the plaintiff here. *In the absence of a true business partnership for the purpose of the transaction, which the court finds did not exist here,* the intent and purpose of the former category are not imputed to the latter category, nor does the situation of the former for tax purposes necessarily determine the situation of the latter." (Emphasis ours.)

This paragraph *clearly* indicates that the trial Court was using the term "joint venture" as synonymous with "joint investment" or "joint ownership" and not as synonymous with a business partnership or undertaking. A partnership is an association of two or more persons to carry on as co-owners a business for profit. (California Corp. Code, §15006.) A joint venture is generally defined as a partnership for one particular undertaking. While the definition of "partnership" for tax purposes may be broader than the definition for state law purposes, nevertheless, the

ingredient of carrying on a business is found in all the cases.

The distinction between a (true) joint venture or partnership and joint ownership is now well recognized, and the latter is held not to have the tax incidents of a partnership. *Estate of Edgar Appleby,*[5] 41 B.T.A. 18 (1940) Aff'd 123 F.2d 700 (C.C.A. 2, 1941).

Before a tenancy in common can be converted into a joint venture or partnership, there must be an *affectio societatis;*[6] i.e., an intention to form such an entity. Although this intention must be ascertained from all the facts rather than from what the parties say, it is clear that in the present case no evidence points toward an intention by Appellee to be a mem-

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[5]Also, see: *Amy Gilford,* 201 F.2d 735 (CA 2, 1953), affirming 11 TCM 175 (1952), where taxpayers unsuccessfully asserted that a tenancy in common constituted a partnership in order to preserve a capital loss carryforward.

Daniel S. W. Kelly v. Commissioner, 16 TCM 34 (1955), where taxpayer asserted that a tenancy in common constituted a partnership to impute misappropriated income which he recovered in a suit against his co-tenant to the year, now barred by the statute of limitations, in which it had been earned by the "partnership."

Lena Hahn, 22 TC 212 (1954), where taxpayer asserted that tenancy in common constituted a partnership so that only the distributive share was gross income for purposes of the $600 income test for dependents.

Coffin v. U. S., 120 F. Supp. 9 (D.C., Ala., 1954), where taxpayer unsuccessfully asserted that he sold a partnership interest rather than his tenancy in common interest in certain real estate.

Charles E. Tibbals, 17 TCM 228 (1958), where the Commissioner asserted that the purchase, development and sale of 435 lots by two brothers who held title as tenants in common constituted a partnership, but the court held that no partnership was intended or existed, upholding capital gain treatment.

[6]Taubman, *The Joint Venture and Tax Classification,* pp. 349, Federal Legal Publications, 1957, New York.

ber of a joint venture, the existence of which she was not even aware. (R. 15.) In *Charles E. Tibbals v. Commissioner,* 17 TCM 228 (1958), the Tax Court rejected the argument of the Commissioner that taxpayer, who was a tenant in common with his brother, (who was in the real estate business) had formed a joint venture. The Court said:

> "The principles adopted by the courts for determining whether a partnership exists for tax purposes are equally applicable in ascertaining the existence of a joint venture. The question whether the parties really and truly intended to join together to carry on a business as partners depends upon their intention. Their intention is a question of fact to be determined from testimony disclosed by their 'agreement' considered as a whole and by their conduct in execution of its provision. *Commissioner v. Culbertson,* 337 U.S. 733."

Appellee could have had no intent to form a joint venture with people she did not even know merely because of her receipt by gift of an interest in land. (R. 119.) To hold otherwise would make a partnership interest a servitude which runs with the land rather than a voluntary undertaking.

Even if it were held that the *trust* for the benefit of the Appellee became a member of a joint venture in April or May of 1953 and that George Williams' intent would be imputed to it, it does not follow that the same intention would run to Appellee, who later received her interest unconditionally and without knowledge of any commitments in regard to the land.

The intent of a prior owner in a chain of title to hold property for sale to customers in the ordinary course of a trade or business is not imputed to the transferee of that property.[7]

In the companion case[8] to this case, the Tax Court said:

> "It is our conclusion after considering all of the evidence and after having heard and weighed the testimony of all the witnesses—and we have hereinabove found as an ultimate fact—that petitioner did not, at any time, hold her 1 per cent undivided interest in the San Bruno lands primarily for sale to customers in the ordinary course of a trade or business; and we further conclude, that *she may not properly be regarded, by imputation or otherwise, to have been a member of any business organization* which was, during the period when she owned her 1 per cent

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[7] *Garrett v. U. S.*, 120 F. Supp. 193 (Ct. Cl., 1954), where the intent of decedent, a subdivider, was not imputed to his estate, even though the executor retained decedent's real estate office and the will authorized such activity.

James G. McConkey v. U. S., 130 F. Supp. 612 (Ct. Cl. 1955), where heirs of a mortgagee who repossessed property were not held to be bound by the intent of the mortgagor, who was a subdivider.

Western and Southern Life Insurance Company v. U. S., 163 F. Supp. 827 (Ct. Cl. 1958), where the intent of a subsidiary to hold property for sale to customers was not imputed to the parent corporation, which received the property on liquidation of the subsidiary.

Louis Greenspon v. Commissioner, 229 F. 2d 947 (8th Cir., 1956), which held that the shareholders were entitled to capital gain treatment on sale of inventory property distributed to them from a corporation, even though the case describes them as "liquidating agents for the corporation" and even though they continued to be shareholders in other corporations which sold the same type of property.

[8] *Katherine Anne Berryman v. Commissioner*, 37 T.C. No. 7 (1961).

undivided interest, holding the land for sale to customers in the ordinary course of a trade or business. Thus it follows, and we here hold, that the petitioner's gain here involved is long-term capital gain from the sale of a capital asset." (Emphasis added.)

In light of the above, it is submitted that the District Court did not find that Appellee was a member of a joint venture in the sense that the term "joint venture" is used in IRC §761(a).

C. EVEN IF APPELLEE WERE HELD TO BE A MEMBER OF A JOINT VENTURE, THE (ASSUMED) INTENTION OR PURPOSE OF OTHERS TO HOLD THE PROPERTY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF A TRADE OR BUSINESS WOULD NOT BE IMPUTED TO HER. THE INTENTION OR PURPOSE OF THE INDIVIDUAL PARTNER IS CONTROLLING OF THE TAX EFFECTS UNDER IRC §702(b), NOT THE (SUPPOSED) INTENTION OF THE ENTITY.

Even if Appellee were held to be a member of a joint venture, the (assumed) intention or purpose of others to hold the property for sale to customers in the ordinary course of a trade or business would not necessarily be her intention and cannot be imputed to her merely because of the relationship.[9]

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[9]It should be noted in any discussion of "imputed intention" that the assumption by the District Court that George W. Williams held his fractional interest as property other than a capital asset was an assumption for purposes of judicial economy only. It is not conceded that George W. Williams and other co-owners, as individuals, were dealers in real property. The legal argument is merely made that, even assuming they were and had the intention to hold this property for sale to customers in the ordinary course of a trade or business, such intention is not imputed to Appellee.

Internal Revenue Code §702(b) in effect at all material times provided:

> "The character of any item of income, gain, loss, deduction or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership."

It is clear from a reading of the legislative history of this provision that the partnership is merely a conduit through which pass various items realized by the partners, and the character of the items is determined at the level of the individual partner, not at the partnership level. While the partnership is an entity for purposes of filing an information return and making certain elections, (e.g., the election to report on the installment basis) that the character of the item is determined at the individual partner's level is not open to serious doubt. Thus, a dealer in real property could not avoid ordinary income reporting by running title through a partnership which had not theretofore been in the real estate business.

The business activity of the partnership is important only in that it is one component in determining whether the partner is in the business of holding property for sale to customers in the ordinary course of a trade or business.

Senate Report No. 1622, accompanying HR 8300, 83rd Congress, Second Session (the Internal Revenue Code of 1954), provides at page 89:

"(a) Income of Partners—under the House and your Committee's bill, as under present law, partners will be liable individually for income tax on their distributive shares of partnership income. The partnership will act as a mere conduit as to income and loss items transferring such items directly to the individual partners.

"The items required to be segregated retain their original character in the hands of the partner as though they were realized directly by him from the source from which they were realized by the partnership and in the same manner."

In the "Detailed Discussion of the Technical Provisions of the Bill", accompanying said Senate Committee Report, it states at pages 376 and 377:

"Subsection (b) contains a 'conduit' rule which makes clear that the character of any item realized by the partnership and included in the partner's distributive share, shall be the same as though he had realized such income directly, rather than through his membership in the partnership, from the source from which it was realized by the partnership and in the same manner."

The House of Representatives Report accompanying HR 8300, House Report No. 1337, 83rd Congress, Second Session, page A222, is verbatim with the discussion accompanying the Senate Finance Committee Report.

Thus, Appellant's basic statement of law on which the appeal is based is erroneous; namely, that the determination of whether an asset is a capital asset or

is held for sale to customers in the ordinary course of a trade or business is made at the partnership level rather than the partner level. A reading of the Code, Regulations, and the legislative history make this clear.

In a somewhat different but relevant case, this Court has expressly recognized the "conduit" theory and that the character of items sold by the partnership has its impact at the individual partner's level. *Commissioner v. Paley,* 232 F.2d 915 (C.A. 9, 1956).

D. IF IT IS DECIDED THAT THE TRIAL COURT HELD APPELLEE TO BE A MEMBER OF THE JOINT VENTURE AND THE INTENT OF OTHERS IS THEREBY IMPUTED TO HER, THE CASE MUST BE REMANDED FOR RETRIAL BECAUSE THE ONLY EVIDENCE SUPPORTING THIS CONCLUSION WAS IMPROPERLY ADMITTED INTO EVIDENCE WITHOUT FOUNDATION AND OVER OBJECTION OF APPELLEE'S COUNSEL.

If it should be decided by this Court that Appellee was a member of a joint venture and that her membership therein was sufficient to impute the intent of other members to her, then the case must be remanded to the trial Court for retrial. The only evidence upon which the existence of or membership in a joint venture could be based is a certain Memorandum,[10] dated May 23, 1953, which was admitted into evidence to establish Appellee's membership in a joint venture over objection that no foundation had been laid for the existence of a joint venture and that it was irrelevant, imma-

[10]Said Memorandum is set forth in Appendix B.

terial and hearsay as to Appellee. (R. 80, 82, also 78, 79, 81, 83.)

Furthermore, counsel for Appellee later moved to strike said Memorandum on the same grounds and filed with the Court its Memorandum of Points and Authorities,[11] which was made a part of the trial record. (See R. 120, where the transcript erroneously refers to Exhibit B as Exhibit D.)

The District Court stated that if it did not find there was a joint venture *as to Appellee* (which it did not) that Exhibit B would be stricken from the record, which was not done. (R. 120.)

Likewise, this Court, on July 6, 1961, denied Appellee's motion to expunge said exhibit from the record.

If it is regarded that said exhibit is a part of the record for evidentiary purposes, then it was improperly admitted over objection, the motion to strike was improperly denied, and the case must be remanded for retrial.

If said Exhibit B is part of the record on appeal only for purposes of determining the correctness of the District Court's ruling, then it is not in evidence and cannot be considered as evidence to determine the correctness of the decision below. In this event, the decision of the District Court must be affirmed on the basis that the evidence overwhelmingly supports the decision of the trial Court.

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[11]Pertinent portions of the Memorandum of Points and Authorities are set out in Appendix C.

VIII. SUMMARY

The question presented in this case was one of fact. The evidence shows that the judgment of the District Court was not "clearly erroneous" but actually shows that no other decision was possible. The record likewise supports the findings and conclusions of the District Court that Appellee was not a member of a joint venture as the term is used in IRC §761(a), and even if she were, the intent of others was not imputed to her. Furthermore, as a matter of law, there would be no imputation of intent, since the tax characterization to partner in a partnership holding and selling property is made at the partner level; the partnership is deemed merely a conduit through which title passed.

The *only* evidence to support a partnership was improperly admitted, and if the case is to be reversed it must be remanded for retrial because of this error.

Dated, San Francisco, California,
November 3, 1961.

Respectfully submitted,
EUGENE J. BRENNER,
HARRY L. FREEMAN,
Counsel for Appellees.

(Appendices A, B and C Follow)

Appendices.

Appendix A

Internal Revenue Code of 1954 (26 U.S.C.): SEC. 702. INCOME AND CREDITS OF PARTNER.

(a) GENERAL RULE.—In determining his income tax, each partner shall take into account separately his distribute share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

(3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in section 170(c)),

(5) dividends with respect to which there is provided a credit under section 34, an exclusion under section 116, or a deduction under part VIII of subchapter B,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) partially tax-exempt interest on obligations of the United States or on obligations of instrumentalities of the United States as described in section 35 or section 242 (but, if the partnership elects to amortize the premiums on bonds as provided in section 171, the

amount received on such obligations shall be reduced by the reduction provided under section 171(a)(3)),

(8) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary or his delegate, and

(9) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

(b) CHARACTER OF ITEMS CONSTITUTING DISTRIBUTIVE SHARE.—The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Source: New.

(c) GROSS INCOME OF A PARTNER.—In any case where it is necessary to determine the gross income of a partner for purposes of this title, such amount shall include his distributive share of the gross income of the partnership.

SEC. 761. TERMS DEFINED.

(a) PARTNERSHIP.—For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title (sub-

title), a corporation or a trust or estate. Under regulations the Secretary or his delegate may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of—

(1) for investment purposes only and not for the active conduct of a business, or

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income. . . .

* * * * *

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business) but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * * * *

REGULATIONS

Reg. (TD 6175, filed 5-23-56). §1.702-1 *Income and credits of partner.—(a) General rule.* Each partner is required to take into account separately in his re-

turn his distributive share, whether or not distributed, of each class or item of partnership income, gain, loss, deduction, or credit described in subparagraphs (1) through (9) of this paragraph. (For the taxable year in which a partner includes his distributive share of partnership taxable income, see section 706(a) and §1.706-1(a). Such distributive share shall be determined as provided in section 704 and §1.704-1). Accordingly, in determining his income tax:

(1) Each partner shall take into account, as part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the combined net amount of such gains and losses of the partnership.

(2) Each partner shall take into account, as part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the combined net amount of such gains and losses of the partnership.

* * * * *

(b) *Character of items constituting distributive share.* The character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in section 702(a)(1) through (8) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. For example, a partner's distributive share of gain from the sale of depreciable property used in the trade or business of the partnership shall be considered as gain from the sale of such depreciable

property in the hands of the partner. Similarly, a partner's distributive share of partnership "hobby losses" (section 270) or his distributive share of partnership charitable contributions to churches, educational organizations, or hospitals, (section 170(b)(1)(A)) retains such character in the hands of the partner.

* * * * *

Appendix B

MEMORANDUM

April 23, 1953
South San Francisco

Re: San Bruno Lands Incorporated

Today at a meeting of George Williams, Martin Wunderlich, Andrew Conway and Thomas Culligan, with Robert Crane also present, the parties discussed the purchase of San Bruno Lands Incorporated, a California Corporation and determined that they would make the purchase if the sale could be consummated with the present stockholders, and that the following plan would be carried out.

It is understood that the individuals present were representing various other interests, such as controlled corporations, ~~trusts for their children,~~ and etc., but that the only parties with whom each would have to deal would be George Williams, Frank Burrows, Andrew Conway, Thomas Culligan and Martin Wunderlich. That these individuals controlled the interests which they represented and were in a position to make all necessary decisions for these interests.

An agreement is to be prepared for the purchase of the stock, with Conway and Culligan contributing $116,666.00, Williams and Burrows $233,333.00 and Wunderlich contributing $350,000.00. The balance of the purchase shall be obtained by a loan of approximately $750,000.00 from the American Trust Company, with $250,000.00 being paid off upon the liquidation of San Bruno Lands and $500,000.00 by a loan in

that amount from the San Francisco Bank secured by a Deed of Trust on all the property. The property shall be owned by the parties hereto as tenants-in-common with the interests of each in proportion to contribution. Mr. Gasser, the representative of the present stockholders of San Bruno Lands, shall be contacted immediately and an attempt made to work out the terms of purchase of all of the stock of that Company. Negotiations will attempt to have present condemnation proceedings, 15 acres for school and 40 or 50 acres for the Wherry Housing Act, consummated before title to the stock is transferred. If this cannot be done, the Corporation will be liquidated immediately on purchase of all the stock and the Wherry Housing Act Condemnation stalled for six months. The parties are all flexible and will go along with whichever or whatever arrangement seems the most desirable or which can be worked out.

After the San Bruno Lands Company's (sic) liquidated, whether this be immediately upon acquisition or after a six months' holding period, with this question to be determined upon further consideration, parties shall for (sic) a development corporation with the stock holdings in that development corporation as follows:

Williams and Burrows	⅓ interest
Conway and Culligan	⅓ interest
Wunderlich	⅓ interest

This corporation will be so organized that it will be in a position to buy the real property from the indi-

vidual owners and allow the individual owners to take a capital gain. The development corporation, or a series of development corporations organized on the same basis, will purchase, either in one piece or in several parcels over a period of time, all of the real property which was formerly owned by San Bruno Lands Incorporated except the approximate 142 acres, commonly known as the "Navy Piece". The development corporation will pay for said land an average of $2000.00 per acre, which sum may vary with the individual parcels but which shall meet that average by the time all the property has been purchased. The Navy Parcel will be held by the individuals or their interests in the same proportion as their original contribution. The parties have all agreed that the above transactions be carried out in a manner which is most advantageous tax-wise.

The parties intend that the development company or companies will develop the real property by the construction of homes and the development of business areas. However, the parties further anticipate certain acreage will be sold to outside parties as soon as the capital gain can be realized so that the original loan to the San Francisco Bank can be retired as quickly as possible.

TJC
MW
FFB
AJC
MHW

(N.B. The copy admitted into evidence of the above exhibit was a carbon copy initialed on the first page by four and on the second page, by five of the parties thereto. On the first page, the words "trusts for their children" were stricken out and three of the initials appear in the margin opposite thereto. Note the difference between this and Appendix C in Appellant's Brief, which does not indicate that said words had been stricken.)

Appendix C

MEMORANDUM OF POINTS AND AUTHORITIES RE NONADMISSIBILITY OF "MEMO OF APRIL 23, 1953" MARKED EXHIBIT B FOR IDENTIFICATION HEREIN

. . .

The testimony shows that a document exists which refers to the purchase of the stock in San Bruno Lands, Incorporated and ultimate acquisition of its property. It was entitled "Memorandum, Re: San Bruno Lands, Incorporated, April 23, 1953, South San Francisco, Calif." The testimony also establishes that said document was not signed, that it was initialed by the parties, that it makes no reference to the plaintiffs herein, that they did not sign or initial it, that it does not purport to bind plaintiff, Lois W. Rosebrook, that it was acquired by the revenue agent from a file in Culligan Development Company offices.

II

SAID DOCUMENT IS NOT ADMISSIBLE IN EVIDENCE FOR THE FOLLOWING REASONS:

A. The Memorandum Is Hearsay as to Plaintiff

Hearsay is testimony or documentary evidence submitted to support the truth of the statements contained therein which is being given other than by the person who has purported to have authored the binding statements. Plaintiff herein was not a party to this memorandum; indeed did not know of its existence. The statements contained therein are hearsay as to her.

1. *Parish's Estate v. C.I.R.,* 187 F.2d 390 (C.A.-7, 1951), 40 A.F.T.R. 286, 1951-1 U.S.T.C. Paragraph 10, 794.

. . .

Plaintiff in the present case is no more an author of the statements which defendant seeks to admit than the decedent or his executor were of the statements in the affidavits or letters in the *Parish's Estate* case. As to plaintiff, Lois W. Rosebrook, they are hearsay.

2. *Niederkrome v. the Commissioner,* 266 F.2d 238 (C.A.-9, 1958), 2 A.F.T.R. 2d 6155, 58-2 U.S.T.C. Paragraph 9944. Cert. den. 359 U.S. 945 (1959).

. . .

. . . The 9th Circuit said:

". . . It is obvious such an affidavit was not in itself admissible under these rules. Even if this document were admissible, it laid no foundation for the introduction of the minutes . . . *against taxpayers who were not present, even according to the purported minutes.* The whole recorded transaction was one between the parent corporation and its Oregon subsidiary. There was no proof that the record was made in the regular course of business . . .

". . . *the transaction had not been consummated when this supposed meeting was held and was only in the negotiation stage.* It was never carried out in the form here outlined . . .

". . . This writing purports to be nothing but the record of a transaction between parent and subsidiary corporations. At best, it is an interoffice memorandum . . . In any event, the taxpayers who are sought here to be charged were *neither*

parties to the transaction purportedly recorded nor to the conversation set down . . .

"On account of these errors, the cause must be reversed and remanded . . . There are questions of fact involved which that tribunal should determine without placing extra burdens on taxpayers . . . And it is difficult to explain how the taxpayers could avoid prejudice in attempting to overcome the contents of the purported minutes, *which were pure hearsay as to all parties in this case.* Judicial officers should have attached no weight or importance to this exhibit." (Emphasis added.)

. . .

Many similarities between the incompetent minutes in the *Niederkrome* case and the incompetent memorandum in the current case exist. They are:

a. Neither document refers to or purports to bind the taxpayer involved.

b. Neither party was an author of the document or a signatory thereto.

c. There is no evidence that either document was made in the regular course of the business of either taxpayer or the parties who purport to be bound thereby.

d. Transactions referred to were not consummated at the time the document was drawn and never carried out in the form outlined.

3. *Standard Oil Co. of Calif. v. Moore,* 251 F.2d 188 (C.A.-9, 1957). Cert. den. 356 U.S. 975.

Niederkrome involved admissibility of corporate minutes under 28 U.S.C.A. Sec. 1732, commonly

known as the Federal Business Records Act. The minutes were excluded from evidence because the proponent sought to admit them to bind a third party (as here) who was not a signatory or party to the minutes, nor whose company recorded them. *Niederkrome* cites what is now the landmark in this area, *Standard Oil of California v. Moore*, also decided by the Ninth Circuit, to which this case would go, if appealed.

. . .

> "It follows that a writing which does not pertain to a matter in which the business was a direct participant, but to some incident, circumstance, or activity outside that business, is not a memorandum or record of an 'act, transaction, occurrence, or event' within the meaning of the statute."

Since the writings sought to be admitted concerned the marketing policies of companies *other than the one in whose files the writing was found,* they were not admissible.

. . .

B. The Memorandum Is Not Relevant

1. See the *Parish, Niederkrome* and *Moore* cases cited above. It has no logical tendency to establish the matter sought to be proved, *as to this plaintiff.*

. . .

Respectfully submitted,

Eugene J. Brenner,

Harry L. Freeman,

Attorneys for Plaintiffs.